

DOCUMENT RESUME

ED 226 639

HE 015 868

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TITLE The Status of University Financial Reporting.
INSTITUTION National Association of Coll. and Univ. Business Officers, Washington, D.C.
PUB DATE Sep 82
NOTE 7p.
AVAILABLE FROM National Association of College and University Business Officers, One Dupont Circle, Suite 510, Washington, DC 20036.
PUB TYPE Reports - Research/Technical (143) -- Collected Works - Serials (022)
JOURNAL CIT Business Officer; p18-22 Sep 1982
EDRS PRICE MF01 Plus Postage. PC Not Available from EDRS.
DESCRIPTORS Accountants; Comparative Analysis; Educational Finance; *Financial Policy; Followup Studies; Higher Education; *Private Colleges; Publications; *Reports; *School Accounting; School Surveys; Standards; *State Colleges
IDENTIFIERS *Financial Audits

ABSTRACT

The status of university financial reporting was surveyed as an update of a 1976 survey. Of the 100 financial reports analyzed in 1976, 87 were available in 1980, and 39 additional private college reports were assessed. In addition to comparing 16 financial reporting standards used in reports between 1976 and 1980, public and private university financial reporting for 1980 was also compared. Of 800 colleges and universities sent a questionnaire on audit scope and auditor selection/rotation, 70 percent responded. For the financial reports, four comparisons concerning the Auditor's Opinion section and eight comparisons concerning the Recommended Accounting Practices section were made. The Recommended Accounting Practices section was also compared for audited and unaudited reports. It is concluded that while there were indications of increased compliance between 1976 and 1980 for certain comparisons, the present level of comparability was inadequate. An excess of 10 percent of the 1980 unaudited financial reports were on the cash basis. The level of comparability was higher for private colleges. In addition, independent auditors predominated over statutory auditors in a ratio of two to one. Recommendations regarding the publishing of financial reports and authoritative sources for reporting are offered. (SW)

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The Status of University Financial Reporting

By JOE R. FRITZEMEYER, DENNIS MITCHEM, and GERALD SNYDER

During the last 15 years, the financial reporting practices of colleges and universities have undergone change. For the period 1968 through 1973, the authoritative source for college and university financial reporting was the 1968 edition of *College and University Business Administration (CUBA)*.

In 1973, *Audits of Colleges and Universities* (the audit guide) was issued by the American Institute of Certified Public Accountants (AICPA). In 1974, Part 5 of NACUBO's Administrative Service was issued (and incorporated into future CUBAs). In 1975 the *Higher Education Finance Manual (HEFM)* was prepared by the National Center for Higher Education Management Systems (NCHEMS) and issued by the National Center for Education Statistics. These three publications now constitute the authoritative base for interpreting generally accepted accounting principles as they apply to financial reporting of colleges and universities.

Potential changes appear on the horizon, however. During the last several years, two authoritative pronouncements have been issued by the AICPA that could have a significant effect on generally accepted ac-

counting principles as they apply presently to colleges and universities. In late 1978, *Statement of Position 78-10, Accounting Principles and Reporting Practices for Certain Non-profit Organizations* was issued by the AICPA. Although this statement applies only to nonprofit organizations not covered by an existing audit guide, there are several significant differences between this statement of position and the audit guide for colleges and universities. Hence, there may be impetus in the near future for consistency of generally accepted accounting principles among all non-profit organizations.

In December 1980, the AICPA issued *Objectives of Financial Reporting by Non-Business Organizations*. Based on the objectives developed for nonbusiness organizations and the objectives previously developed for business enterprises, the now-stated goal is to "develop an integrated conceptual framework that has relevance to all entities." Hence, significant changes to generally accepted accounting principles as they apply not only to colleges and universities but to all nonprofit/nonbusiness organizations could be forthcoming. Also, the possible formation of a Governmental Accounting Standard Board raises the possibility of public colleges and universities being governed by standards not applicable to independent colleges and universities.

This article is principally an update of an earlier article that appeared in the September 1978 *Business Officer* on the status of university financial reporting, based on a review of fi-

nancial reports for fiscal years ending in 1976. The conclusions presented in the previous article consisted of the following:

○ For all reports, without distinction between audited and unaudited reports, the level of comparability is inadequate. Significant factors leading to this conclusion were as follows:

○ Forty-one percent of the published university financial reports in 1976 were unaudited, with unaudited reports having a higher rate of noncompliance with recommended practices. For example, 22 percent of the 1976 unaudited reports were on the cash basis.

○ A significant portion of the audited reports, 8 percent, used an incorrect accounting principle that required a qualified opinion.

○ Less than half the reports, both audited and unaudited, were in compliance with the recommended classification of current funds revenues and expenditures.

○ A significant portion of the reports, both audited and unaudited, did not show an equalization of restricted current operating funds revenues and expenditures.

○ Audited financial reports were more comparable than unaudited ones. The overall conclusion was that the level of comparability for audited reports was marginally adequate. This conclusion was based on the satisfactory level of comparability for many reports, but was weakened due

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to the instances noted for certain audited reports not being in compliance with some of the authoritative requirements, thereby resulting in a deficient level of comparability.

In addition to being an update of the previous article, this article also contains a comparison between public and independent university financial reporting, an aspect not covered in the previous article, and also covers current policies regarding audit scope and auditor selection/rotation.

Introduction to the Research

For the 1976 financial reporting survey, a review was made of 100 university financial reports for comparison to 16 criteria selected by the authors. For the 1980 survey, 87 of the 100 financial reports used in 1976 were available to the authors at the time of starting the research, a level deemed adequate for determination of any significant, definite trends during the four years as to university financial reporting. It should be noted that, while selection of the college and university financial reports used for the survey was not on a random basis, the relatively large number of reports included in the survey is such that, in the opinion of the authors, useful observations could be made from the survey. The objectives of the authors were to include a sizable number of reports in the survey, yet limit the sample size to a manageable level.

The sample of 100 financial reports in 1976 consisted of 81 public and 19 independent university reports. Because of the limited number of independent university reports in the 1976 sample, no comparison was made at that time between public and independent universities. However, for this update, the survey was expanded to include a comparison between public and independent university financial reporting. Therefore, in addition to having 87 of the 100 financial reports used in the previous survey (69 public and 18 independent university reports), 39 additional independent reports available to the authors were included in this survey so that public and independent reports could be compared.

As a supplement to analysis of the financial statements noted above, a questionnaire survey was conducted of 800 colleges and universities. The response rate was 70 percent. Institutions included in the survey were those having in excess of 1,000 stu-

dents, exclusive of branch or affiliated campuses. The questionnaire was directed toward audit scope and auditor selection/rotation.

Before presenting the research results, distinction needs to be made between the terms "in accordance with generally accepted accounting principles" and "in compliance with the authoritative sources." The purpose of the audit guide is to provide guidance and recommendations to public accountants in their examination of financial statements. It is assumed that statements "in accordance with generally accepted accounting principles" are in basic agreement—on material items—with the underlying accounting principles promulgated by the audit guide when the statements are reviewed on an overall basis. The term "in compliance with the authoritative sources" is defined for this research project as being in agreement with the specific recommendations of the audit guide and NACUBO's Administrative Service and without regard to materiality and review of the statements on an overall basis. Therefore, it is possible for a financial statement to be not "in compliance with the authoritative sources" for a specified recommendation while at the same time being "in accordance with generally accepted accounting principles" on an overall basis.

For example, less than half the audited financial reports in the 1976 survey were in compliance with the recommended classification of revenues and expenditures. In addition, approximately one-sixth of the audited reports were not in compliance with the showing of restricted current funds revenues as being equal to restricted expenditures. Yet none of the auditors took exception of these practices in their opinions. In summary, what is presented is a two-way comparison to the 16 financial reporting standards: a comparison between 1976 and 1980 using basically the same reports for both years and a comparison between public and independent institutions using only 1980 financial reports.

For the 100 sample reports in the 1976 survey, current operating funds revenues totaled \$14.2 billion; for the 87 reports in 1980, \$18.4 billion. The average per institution was \$142 million and \$211 million, respectively. Hence, a significant portion of combined current operating funds revenues of all higher education institutions is included in this survey.

The comparisons used for this research are presented according to the

following three categories: Auditor's Opinion, General Reporting, and Recommended Accounting Practices. For many of the comparisons, the level of comparability among the reports is determined by comparing the reports to the recommended reporting practice as indicated in the audit guide and Administrative Service. No presumption should be made that these are necessarily all or even the most important comparisons.

As a final comment before presenting the research findings, caution is made against placing unwarranted preciseness on the research findings. The intended objective of the research was determination of major definitive trends, not changes of only several percentage points. Relatively minor changes between 1976 and 1980 could easily be due to only 87 of the 100 reports previously used being available for this survey and the use of different research personnel between years, even though under the same supervision, which could result in different interpretations. For all major definitive trends indicated by the research, however, supervisory verification was made of the trend.

For public institutions, especially those publishing unaudited reports, deviation from the authoritative sources may be the result of state-mandated reporting practices. Therefore, some caution must be exercised relative to public institutions when interpreting the meaning of such noncompliance data. For this survey, the objective was to determine whether there was compliance with the authoritative sources; the scope of the survey did not include for public institutions the reason for such noncompliance.

Auditor's Opinion Section

Four comparisons concerning the Auditor's Opinion Section were made. The first deals with determination of the proportion of published university financial reports containing an auditor's opinion with the report, consisting of either an opinion of independent public accountants or state auditor. The Administrative Service recommends that an auditor's opinion be included with published financial reports. One of the primary benefits of having an auditor's opinion is that the reader has a higher level of confidence in the report. The findings indicate that for the comparison between 1976 and 1980, consisting of 100 financial reports in the 1976 survey and 87 reports in the

1980 survey, only 59 percent of the 1976 financial reports and 61 percent of the 1980 reports contain an auditor's opinion. Comparison between public and independent institutions indicates that all the sample independent reports are audited, whereas only half the public reports contain an auditor's opinion.

The second comparison is on determination of whether a relationship exists between the size of the university and whether the financial report is audited. The relative size of the universities was determined on the basis of each university's current operating funds revenues. As noted for the first comparison, only approximately 60 percent of the published financial reports are audited. However, if the universities audited are the larger universities, the percentage of "total university financial affairs" audited would then be above this 60 percent level. The findings are that no significant relationship exists between the size of the university and whether the university is audited. However, a relationship does exist for public universities as to state of domicile. For certain states, all of the sample university financial reports of that state contain an auditor's opinion, whereas for certain other states none of the reports contains an auditor's opinion. This situation results primarily from differences in state laws and in procedures of the respective state auditors.

The third comparison is on determination of the proportion of audited financial reports that contain a qualified opinion. In reviewing qualified opinions, distinction was made between nonrecurring and recurring qualified opinions. Nonrecurring qualifications are those that typically will not be repeated in future years, such as qualifications due to consistency between years. Recurring qualifications are those that typically will continue in future years, such as qualifications for use of an incorrect accounting principle or for property record retention problems. For 1976, 21 percent of the opinions were qualified, whereas for 1980 there were only 7 percent. However, for the sample of independent university financial reports, 18 percent of the auditor's opinions were qualified in 1980. Of particular interest is the situation in 1980, where 10 percent of the audited reports contain a qualified opinion due to use of an incorrect accounting principle, a situation that could be rectified by the university.

The fourth comparison is on the timeliness of financial report issuance, through determination of the period between financial statement date and the auditor's opinion date. The research findings indicate that the average period for issuance of audited reports is approximately three months. Even though this three-month average period does not indicate overall deficiency in the issuing of financial reports on a timely basis, there is room for improvement.

General Reporting Section

For this category of comparisons and the next category, Recommended Accounting Practices, the financial reports for the comparison between 1976 and 1980 are separated between audited and unaudited reports so that separate comparisons and conclusions are possible for both audited and unaudited reports.

The first comparison is on the proportion of reports that are short-form reports, which is recommended by the Administrative Service as best suited for the presentation of financial information intended for external dissemination. The definition of short-form report for this research is that the report contains the three basic statements of Balance Sheet, Changes in Fund Balances, and Current Funds Revenues, Expenditures, and Other Changes, and up to ten pages of supplementary supporting data. For audited reports, only two-thirds of the 1976 reports and three-fourths of the 1980 reports are short-form reports; for unaudited reports, less than half are short-form reports. Universities publishing reports other than short-form reports should reconsider the objectives of the annual financial report and the report readership.

The second comparison is on the proportion of reports containing supplemental statistical and financial highlights information. Determination of the inclusion of supplemental statistical data was based on whether the report contains the number of students enrolled and the number of degrees conferred. The purpose of this comparison was summarized by Daniel D. Robinson in a 1973 NACUBO *Professional File* paper: "I suspect that the day is not too far away when no financial report worthy of the name will be issued in the absence of correlative statistical information that breathes life into the financial data and makes the entire institution more understandable to the reader."

The research findings are that on an overall basis, only approximately one-half of the financial reports contain supplemental statistical and financial highlights information, with a higher proportion of audited reports containing this type of information than unaudited reports.

However, when the sample of reports for this survey is compared on a public versus independent basis, an interesting situation develops. Many of the 39 additional 1980 independent reports added to the survey were fairly small institutions, with their "financial reports" simply being financial statements printed by their auditors, as opposed to being a more comprehensive financial report containing not only the basic financial statements but other data, such as enrollment.

The third comparison is on the proportion of reports containing prior-year data. Both the audit guide and Administrative Service show in the sample financial statements prior-year data for the Balance Sheet and Statement of Current Funds Revenues, Expenditures, and Other Changes. For the Statement of Changes in Fund Balances and the notes, prior-year data are not shown in the sample financial statements. The research findings indicate that a majority of reports show prior-year data for the Balance Sheet and the Statement of Current Funds Revenues, Expenditures, and Other Changes. Less than half the reports show prior-year data for the Statement of Changes in Fund Balances. On an overall basis a higher proportion of audited reports contain prior-year data than do unaudited reports.

The fourth comparison is on the proportion of reports containing the vertical format for the Balance Sheet, as contrasted to the horizontal format. The vertical format is the format used in the sample balance sheet presented in the audit guide and Administrative Service. Research findings are that approximately three-fourths of the reports use the vertical format.

Recommended Accounting Practices Section

Eight comparisons were made in the Recommended Accounting Practices section of the survey. The first is on the proportion of financial reports on the accrual basis of accounting, which is basic for generally accepted accounting principles. The findings for audited reports are that all the reports are on the accrual basis. The findings

for unaudited reports are that 22 percent of the reports for 1976 and 12 percent for 1980 are on the cash basis.

The second comparison is on the proportion of financial reports containing a summary of significant accounting policies, as required by Opinion No. 22 of the Accounting Principles Board. The research findings are that all of the audited reports contain such summaries. For unaudited reports, less than half the reports contained such summaries in 1976, and exactly half in 1980.

The third comparison focuses on the proportion of reports in compliance with the recommended classification structure of current funds revenues and expenditures. The audit guide, as originally issued, was specifically amended one year after issuance for adoption of a revised classification of revenues and expenditures. Impetus for these revisions included efforts of NACUBO and NCHEMS. *Even though the audit guide was specifically amended for a revised classification of current funds revenues and expenditures, the research findings are that, for 1976, less than half the financial reports, both audited and unaudited, were in compliance with this revised classification structure. For 1980, only approximately half the reports were in compliance.* For the public versus independent university comparison, the research findings are in basically the same relative range.

The fourth comparison is on the recommended handling of outstanding encumbrances. Encumbrances outstanding as of year-end need not be shown in the statements or, if shown, must be presented as only a designation of fund balance and not as a liability. This comparison deals with the proportion of reports that reflect outstanding encumbrances in one of the recommended manners. Substantially all the audited reports show outstanding encumbrances in accordance with one of the recommended manners. However, for both 1976 and 1980, one-third of the unaudited reports show outstanding encumbrances as a liability, a presentation at variance with the authoritative sources, with this situation possibly being due to state reporting requirements.

The fifth comparison is on the proportion of financial reports that reflect the authoritative definition of restricted current operating funds. The distinction between restricted and unrestricted funds, as indicated

in the audit guide and Administrative Service, is based on whether use of the funds is externally restricted by the donor or contributing agency for a specified purpose. The research findings for both years are that substantially all the reports are in compliance.

The sixth comparison is on the proportion of financial reports that show an equalization of restricted revenues and expenditures on the Statement of Current Funds Revenues, Expenditures, and Other Changes. As indicated by the authoritative sources, current funds revenues include "restricted resources to the extent that such funds are expended." For 1976, the research findings were that 83 percent of the audited reports and 59 percent of the unaudited reports are in compliance with the authoritative sources in regard to this equalization. For 1980, the relative proportions remained basically the same.

The seventh comparison is on the proportion of financial reports having the recommended handling of mandatory versus voluntary transfers. Voluntary transfers are referred to as nonmandatory transfers in the authoritative sources. Prior to the audit guide, distinction was not made between mandatory and voluntary transfers. The audit guide and Administrative Service recommend that transfers arising from binding legal commitments, such as debt-service requirements of current funds or from agreements with donors or sponsoring agencies for the matching of contributions and grants, be shown as mandatory transfers in both the Statement of Current Funds Revenues, Expenditures, and Other Changes and in the Statement of Changes in Fund Balances.

For this comparison, if the terms "mandatory" and "nonmandatory/voluntary" were used, compliance with this standard was clearly evident. However, if these terms were not used and if there were transfers to restricted funds and/or debt service funds, a question arose as to whether the transfers were mandatory or voluntary; hence, the conclusion was drawn that the report was not in compliance for this comparison standard, due to lack of clear communication in the report. For 1976, the findings were that 81 percent of the audited reports and less than half of the unaudited reports were in compliance with the recommended presentations of mandatory versus voluntary transfers. For 1980, compliance

increased to 90 percent and 70 percent, respectively.

The eighth and final comparison is on the proportion of financial reports that include depreciation. Prior to the audit guide, it was recommended by CUBA (1968) that depreciation accounting not be employed. The audit guide and Administrative Service permit depreciation as an alternative, if depreciation is reported as a deduction in the investment-in-plant section of plant funds. The research findings are that very few of the university financial reports presently show depreciation as a deduction in the investment-in-plant section of plant funds, with most of the reports reflecting depreciation being independent institutions.

Newly Added Comparisons

In addition to comparison of the 1980 financial reports to the 16 comparisons previously used for the 1976 survey, the 1980 reports are also compared to four new comparisons. The first was on the proportion of reports that show an allowance for doubtful accounts. The research findings are that approximately two-thirds of the reports show such an allowance, with a higher proportion of audited reports showing this allowance.

The second comparison was on the proportion of reports indicating use of the total return concept. Research findings were that very few reports, approximately 6 percent, reflect this concept, basically only independent universities. The third comparison was on the proportion of reports reflecting investments recorded at market. Like the previous comparison, very few reports reflect investments on this basis—10 percent of the audited reports and none of the unaudited reports. The fourth comparison dealt with only those reports having investments recorded at cost, and for these reports determination of the proportion of these reports disclosing market value. While 81 percent of the audited reports visibly disclosed market value, only one-half of the unaudited reports disclosed market value.

The questionnaire survey on audit scope and auditor selection/rotation indicated that all 564 institutions responding are audited in at least some areas. For example, some had audited financial statements, whereas others had audits of certain funds or programs only, such as student financial aid programs. These responding institutions also indicated that the

auditors used at their institutions were in the ratio of 2 to 1 independent auditors as compared to statutory auditors (i.e., state, county and/or governing board auditors). Of those responding that use independent auditors, only 73 indicated that they have a policy of periodic rotation of outside auditors.

Conclusions

While there are indications of increased compliance between 1976 and 1980 for certain of the comparisons, the overall conclusions reached in regard to the 1976 survey remain in effect for 1980. For all university reports, and without distinction between audited and unaudited reports, the present level of comparability is inadequate. One of the more significant factors relating to this conclusion is that in excess of 10 percent of the 1980 unaudited financial reports are on the cash basis. For audited reports, the conclusion is that the level of comparability is marginally adequate, as indicated by the research findings. Between public and independent institutions, the conclusion is that the level of comparability is higher for independents, but still not at a desirable level. In regard to the research on audit scope and auditor selection/rotation, certain of the institutions engaging auditors do so for only limited engagements. Independent auditors predominate over statutory auditors in a ratio of 2 to 1. Rotation of auditors by colleges and universities, while being a practice used by many, is not followed by a majority of institutions as a matter of policy.

Recommendations

Colleges and universities not publishing audited financial reports should consider the desirability and resultant benefits associated with the issuance of audited financial reports. The benefits include increased confidence in the financial report by the institution's governing board and other users. As evident from the research findings, a significant portion of the unaudited financial reports are not in compliance with generally accepted accounting principles, the most basic principle being accrual basis accounting, along with not being in specific compliance with other authoritative sources for college and university accounting.

In view of the degree of noncompliance with the present authoritative

sources, the second recommendation is that *fresh consideration be given to the question as to whether the present authoritative sources for college and university financial reporting are serving their intended purposes.* In the view of some, the question raised is whether college and university financial reporting needs to be more complex and difficult to understand than that of business enterprises. The degree of noncompliance with the present authoritative sources would indicate that some people may think not. For those who do comply with the authoritative sources, do they comply because of the belief that the current authoritative sources are the best reporting possibility or do they comply only because they do not want to depart from current conventional wisdom and practice? The authors recommend that additional study and discussion be directed towards the answering of these questions. Possibly, there is no need for a separate audit guide or statement of position on the uniqueness of college and uni-

versity financial reporting.

It is interesting to note that the audit guide, as originally issued, was specifically amended one year after issuance to incorporate a revised classification structure for revenues and expenditures. Supposedly, this revision was in response to those groups and individuals who wanted to articulate a better classification arrangement for communicating college and university data. However, our research findings indicate that only one-half of the institutions of higher education comply with the recommended reporting classifications. This situation seems to indicate that either additional work needs to be done to determine the reporting needs of colleges and universities or there needs to be greater devotion to selling the current recommended practices. ♦

A set of four tables showing the comparisons discussed in the article may be obtained by writing to NACUBO's Information Exchange.

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Newsmagazine of the National
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Business Officer (ISSN 0147-877X)
is published monthly by NACUBO,
One Dupont Circle, Suite 510,
Washington, DC 20036, telephone
202-861-2500. Second-class postage
paid at Washington, DC. Of annual
membership dues, \$30 is for a sub-
scription to *Business Officer*. ©
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